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NEWSLETTER

Franchisor Liability Under the Foreign Corrupt Practices Act

October 9, 2013

The Foreign Corrupt Practices Act (FCPA) constitutes the single most significant compliance challenge for companies operating internationally. Over the last several years, FCPA enforcement activity has skyrocketed, with U.S. authorities seeking ever steeper penalties (often totaling tens or even hundreds of millions of dollars) and aggressively pursuing not just companies but individuals. The $1.6 billion in penalties levied on Siemens by U.S. and German authorities tops the charts, but several other settlements have broken nine figures, including BAES ($400 million), Snamprogetti/ENI ($365 million), JGC ($218 million), and Daimler ($137 million). As Assistant Attorney General Lanny Breuer proclaimed in a November 2010 speech, "[Y]ou are right to be more concerned . . . we are in a new era of FCPA enforcement; and we are here to stay." In this environment, the consequences of failing to undertake appropriate anti-corruption compliance measures can be dramatic.

Critically, FCPA liability can be premised not only on the conduct of a company's own employees but on the conduct of third parties acting on the company's behalf of which the company knew or, in effect, should have known. Of course, the determination of whether the company should have known of the third party's actions is judged in retrospect. As a result, there is a very real possibility that a franchisor may face exposure under the FCPA as a result of the actions of its franchisees, at least in the absence of appropriate before-the-fact training, compliance measures, and due diligence (conducted by qualified outside counsel where appropriate).

Prohibitions of the FCPA

Anti-Bribery Provisions. Broadly speaking, the anti-bribery provisions of the FCPA prohibit companies from, directly or indirectly, offering, promising, giving, or authorizing the giving of money or anything else of value to a foreign (*i.e.*, non-United States) public official in order to obtain or retain business. The U.S. Department of Justice (DOJ) and Securities and Exchange Commission, which have overlapping enforcement authority, give broad interpretations to the key provisions of the FCPA, as noted below.

- The concept "anything of value" covers essentially any form of benefit. Thus, the FCPA extends to more than mere cash payments and can be violated by the provision of such diverse benefits as travel unrelated to a business purpose, excessive gifts or entertainment expenses, scholarships, share of profits, or hiring a foreign official's family member.

- The term "foreign official" covers representatives of a government agency at any level, employees of state-owned enterprises, representatives of political parties, candidates for political office, representatives of international organizations, and members of a royal family. Even an official at an entity that is controlled by a government but not majority-owned may constitute a foreign official. Indeed, on several occasions, the United States has based actions on payments to private individuals and non-government entities, under either the accounting provisions of the FCPA or related statutes such as the false statement or financial crimes statutes.
- A payment (or provision of anything of value) to "obtain or retain business" refers to a wide range of conduct beyond the prototypical payment to win a contract award, including a payment to receive or expedite regulatory approval, obtain an advantage in a pending court case, or receive preferential customs treatment.
- The FCPA's knowledge standard is broader than actual knowledge; it encompasses the concepts of "conscious disregard" and "willful blindness." Thus, a company cannot avoid liability under the anti-bribery provisions by failing to implement anti-corruption compliance measures or recklessly ignoring red flags. Merely doing business in a country known for corruption has served as a basis for finding constructive knowledge of improper payments.

Accounting Provisions. The accounting provisions of the FCPA, which apply to "issuers" (described below), require corporations, including their non-U.S. subsidiaries, to (1) make and keep books and records that accurately and fairly reflect the transactions of the corporation, and (2) devise and maintain an adequate system of internal accounting controls.

FCPA Jurisdiction

The U.S. government's view of the reach of the FCPA is expansive. On several occasions, the government has relied on remote, sporadic connections between the alleged improper payment and the United States to establish U.S. jurisdiction. Moreover, other countries are adopting and more aggressively enforcing their own anti-corruption laws, perhaps most notably the United Kingdom Anti-Bribery Act of 2010; and to a greater extent than ever, international regulators are cooperating in their anti-bribery enforcement efforts. Anti-corruption is now a worldwide concern.

There are three bases for jurisdiction under the FCPA:

- **Domestic Concerns:** The FCPA's anti-bribery provisions apply to U.S. companies and individuals, irrespective of whether they act wholly outside of the United States.
- **Issuers:** The FCPA also applies to "issuers"—primarily companies that have securities listed on a U.S. exchange—and their officers, directors, employees, agents, and stockholders. Non-U.S. companies that list American Depository Receipts (ADRs) on a U.S. exchange also constitute issuers. Jurisdiction over issuers under the anti-bribery provisions of the FCPA requires the "use of the mails or any means or instrumentality of interstate commerce in furtherance" of a bribe.

- **"Territorial" Jurisdiction:** The FCPA's anti-bribery provisions further apply to a non-U.S. person or entity that engages in an act in furtherance of a corrupt payment "while in the United States." Despite the statutory language, the U.S. government does not interpret the FCPA to require an individual to be physically present in the United States. Rather, it takes the position that the necessary territorial nexus is present whenever U.S. mail or wires are used, even if the conduct at issue otherwise falls wholly outside the United States. For example, an email sent from a person outside the United States to another person outside the United States, but which passed through a U.S. server, has sufficed. Similarly, a wire transfer in U.S. dollars between two non-U.S. banks that cleared through a U.S. correspondent bank has served as grounds for FCPA "territorial" jurisdiction.

FCPA Risks for Franchisors

A franchisor that expands internationally has two levels of concern: (1) liability based on the conduct of its own employees and (2) liability based on that of third parties that may be deemed to be acting on the franchisor's behalf, including franchisees and area developers. The latter is likely the principal risk for many companies. A substantial majority of recent enforcement activity has been based on payments made by third parties.

There is a range of international franchising arrangements, with varying degrees of control exercised by the franchisor. The greater the franchisor's involvement in, and control over, the activities of its franchisees, the more likely it is that the authorities will determine the franchisor had the requisite "knowledge" of the improper conduct and corrupt intent. However, with greater control comes greater ability to deter and prevent questionable conduct by a franchisee. Moreover, in other, analogous contexts, U.S. authorities have made clear that a company cannot escape liability by simply turning a blind eye to the possibility that its business partners are engaging in corrupt activities.

At a minimum, a franchisor must conduct adequate due diligence on its international franchisees (and other third parties). Time and time again, the U.S. government has emphasized the central importance of due diligence on third parties with which a company does business. While the DOJ has yet to prosecute a franchisor for FCPA violations, DOJ officials have made it clear that franchisors are indeed subject to the FCPA. Accordingly, a franchisor's failure to appreciate the critical need for due diligence on franchisees and other third parties, particularly those located in high-risk geographic regions, creates potential exposure to an FCPA investigation and claims.

Gregory M. Williams is a partner at Wiley Rein. He has more than a decade of experience working on FCPA and anti-corruption matters. Greg obtained a Master of Arts, with distinction, from The Johns Hopkins School of Advanced International Studies in 1993. He graduated from the University of Virginia Law School in 1997, where he was an editor on the Law Review. He then clerked for the Honorable Jacques L. Wiener, U.S. Court of Appeals for the Fifth Circuit. Greg's anti-corruption experience runs the gamut, including managing worldwide internal investigations, conducting due diligence on international agents, joint venture partners, and other third parties, and designing corporate anti-corruption training programs.

For additional information about the firm's Franchise Practice, please contact Robert A. Smith at 202.719.4481 or rsmith@wiley.law.